

CHALLENGES IN MANAGING A FAMILY BUSINESS

Management and Planning Series

Challenges in Managing a Family Business

replaces *Problems in Managing a Family-owned Business*

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INTRODUCTION

When you put up your own money and operate your own business, you prize your independence. It's MY business, you can tell yourself, in good times and in bad.

In a family company, however, it's OUR business.

When family members work together, emotions may interfere with business decisions. Conflicts may arise as relatives see the business from different perspectives. Those who are silent partners, stockholders and directors are likely to judge capital expenditures, growth and other critical matters primarily by dollar signs. Those engaged in daily operations are more likely to be concerned about production and sales figures and personnel matters. Obviously, there is potential for conflict.

In some family companies, daily operations are hampered by conflict; in others, the challenge is a high turnover rate among nonfamily employees. Growth also may be a dilemma if some relatives are reluctant to plow profits back into the business. Conflict in the business also can be aggravated by family members who have little talent for money or business -- the offspring of company founders who lack business acumen or in-laws who must be employed without regard to their ability or the company's needs.

The manager of a family-owned business faces the same challenges as the owner-manager of any small company. However, the job of family manager may be complicated by relatives who must be reconciled to working together in a business.

This publication discusses such challenges from the viewpoint of the family member who is the company's manager or who is involved in management. It offers suggestions to help you manage effectively and profitably.

KEEPING YOUR EYE ON THE GOAL

Like any enterprise, it is essential that a family business have
A clear mission, a statement of purpose and goals.

! A clear chain of command -- lines of authority -- for decision making.

- ! A clear plan to accomplish goals and provide for orderly succession.
- ! Good communication among family members and with nonfamily employees.

These factors are doubly important in a family business because of the strong emotions that can arise and the confusion that can occur in their absence.

Rights and responsibilities are different at home than at work, and it is imperative that family members keep this fact in mind. At home family relationships and goals are the prime concern. Language is personal, attitudes are subjective, roles -- husband/wife, parent/child, family/relatives/in-laws -- are traditionally defined.

At work, however, the success of the business must be paramount. Language becomes more impersonal, attitudes more objective. Family members who work in the business must accept the boss/employee relationship, as they would in any other business. Their job descriptions must be clear, in writing and adhered to. Problems arising at home should be left there when the workday begins and workplace problems should not encroach on home life. Family members who accept and observe the home/business dichotomies not only avoid strained personal relationships, but also convey an important message to all employees that in the workplace business goals come first.

This, of course, is the ideal situation.

THE SPARKS FLY

What happens when family behavior in the workplace falls short of the ideal? Differing opinions do not always produce discord in a family-owned company, but they are more apt to cause sparks to fly. Emotion is the added dimension as brothers and sisters, uncles and aunts, nephews and nieces, and parents and children work together.

The individual managing such a company must recognize the emotional dimension and make the necessary objective decisions to ensure smooth functioning. Among members of a family who are active in a business, it may be hard to be objective about one another's skills and abilities. He was lazy when we were kids, and he's still lazy. What does Aunt Bess know about the business? She's only here because of her father's money.

If emotional outbursts affected only the family, the manager might knock a few heads together and move along. But quarrels and ill feelings among relatives affect nonfamily employees as well.

The manager's challenge is to keep the bickering from interfering with work. In an emotional atmosphere nonfamily employees may be tempted to base their decisions on family tensions --- they know how their bosses react and are influenced by this knowledge. But the company cannot become a warring camp. All employees must understand that their interests are best served by a

profitable organization, not by allegiance to particular family members.

The leader of the family business must not take sides with any member of the family, but rather must demonstrate that disagreements will not be permitted to affect the business. This attitude discourages nonfamily employees from politicking for position. When the family leader demonstrates respect for the family and an understanding of the differences, nonfamily employees are not tempted to play politics.

IS THE MANAGER REALLY IN CONTROL?

- ! The president of a small family-owned company is not necessarily the person in charge. The family elder statesman may be president or chairman of the board of directors, but day-to-day management may be in the hands of other family members.
- ! The ceiling may be too low on the amount of money that can be spent without permission from too many members. Unrealistic or unnecessary clearance procedures may result in missed opportunities for increased profits, such as failing to take advantage of a good price on raw materials or sales inventory.
- ! Personalities and emotional reactions work against efficient operation. For example, even routine matters must be authorized by top family members because Uncle Bill never lets you forget your mistakes.
- ! Efficiency may be reduced by relatives' engaging in excessive family talk during working hours. The manager must set an example and insist relatives refrain from chit-chat on the job.
- ! Managers may owe their positions to their age or to the amount of capital they have invested and may lack leadership ability.
- ! Some family managers may hinder progress because they do not know how to listen.

Family members in charge of operations must be

- ! Capable of using efficient management techniques.
- ! Thick-skinned enough to live with family bickering.
- ! Tough enough to make decisions stick.

Definite lines of authority are essential when a member of the family manages operations and other relatives fill various jobs. Family employees must discipline themselves to work within the

lines of authority and the responsibilities of family members should be spelled out. Even then, it is wise to have a nonfamily employee highly involved in operations, to help resolve problems.

One solution to management problems is to let someone else -- a hired manager -- run the day-to-day show. The family member retains a title and some authority, but the hired assistant acts as a buffer between the family and the organization. The assistant might be executive vice president or chief operating officer and the family member, president or chief executive officer.

With a hired manager, the family leaders are free to work on future strategy, basic policy and growth, while the nonfamily employee guides day-to-day operations.

The authority of the manager, whether family or nonfamily, to suspend or discharge flagrant violators of company rules must be clear. Management control is weakened if family employees are exempt from rules.

WHO'S IN LINE TO TAKE OVER?

An important issue that requires early planning is Who will take over when the family member managing the business dies or retires? Planning is especially critical when the top family member approaches retirement age or is in poor health, but the best time to prepare for orderly succession is before transition looms. A family meeting in a neutral setting away from interruptions can help focus discussion, perhaps with the assistance of a professional consultant to guide the agenda.

Consideration on the agenda should be given to

- ! Family goals for the future.
- ! Plans of next-generation family members.
 - Who is interested in staying with the business?
 - Who has the most aptitude for leadership?
 - What if several able younger family members aspire to lead the business?
 - What role will other younger members play?
 - What if next-generation family members are not interested in the business?
- ! Grooming of future leaders.
- ! The most likely times major transitions will occur, barring unexpected illness or death.

- ! Preparations of present leaders for stepping down.
- ! Financial aspects of leadership transitions.

The importance of preparing for succession before a new leader must take over cannot be emphasized too strongly.

YOUR BROTHER-IN-LAW NEEDS A JOB

A common challenge in a family enterprise is that of relatives who lack an aptitude for the business, or any apparent usable talent or skill, but also who must be hired. The emotional pressure is hard to resist when your sister says, Bob needs a job, badly!

Accept the challenge with your eyes open, because it will be hard to fire Bob, even if his employment costs the company more than it earns. Moreover, he could demoralize other employees if he loafs on the job, avoids unpleasant tasks, takes special privileges or otherwise exhibits a poor attitude.

Training Bob may require extra effort, but few people are totally unskilled.

- ! Endeavor to cultivate a talent he possesses that will contribute to the business.
- ! Provide special training.
- ! Assign him to special projects to reduce negative contact with other employees and to provide an opportunity for developing skills.
- ! Arrange for him to work under a nonfamily supervisor who is a top producer.

The key is to transform the untalented, minimally skilled relative into a productive employee, as quickly as possible.

PERSONNEL PROBLEMS

A common challenge to family-owned companies is high turnover among top nonfamily employees. Some relatives resent outside talent and can make things unpleasant for nonfamily executives. Also, top-notch managers and workers may leave if most promotions go to family members. Exit interviews are useful to find the cause of high turnover. A departing key employee may tell you enough to help you develop a positive course of action.

Again, it is wise to counsel nonfamily employees to not take sides in family disputes. Outside employees who demonstrate fairness and compatibility become a stabilizing force in the company. The family needs these people and should assure them of a future with the firm.

Confronting a trouble-causing relative is difficult at best, and firing one may be out of the question. Consider these alternatives:

- ! Counsel the family member on the responsibility to set an example.
- ! Encourage the relative to start a business in a noncompeting line, if he or she has the management ability necessary for success.
- ! Transfer the relative to a branch office.
- ! Find him or her a job with another company.

In short, if you are unable to fire troublemakers, try to change their attitudes or change their jobs.

SPENDING TO SAVE MONEY

Many times, as owner-manager, you know a specific investment will improve efficiency or profits, but other family members may see the move as just another expense. They view such expenditures as encroachments on year-end dividends. It is important that these relatives understand the concept of spending money to make money.

- ! Base your arguments on facts and figures gathered by nonfamily employees.
- ! Suggest that the matter be settled on a bottom-line basis by demonstrating how Spending "\$x for this machine will increase our profits by \$y annually and will return our money in four years."

Should opposing relatives reject your projection, enlist the help of outside advisers. Relatives may be more likely to believe a banker, accountant or attorney than to accept your judgment. Keep in mind that it is unwise to have outside advisers who are personally close to other family members.

In other situations, paid consultants can help prove the worth of an opportunity. Such help is particularly valuable with projects requiring specific expertise or intensive research.

MAINTAINING THE STATUS QUO BLOCKS GROWTH

As relatives in a family-owned business grow older, they may develop a preference for maintaining the status quo. They become wary of change and afraid of risk. This attitude can, and often does, block business growth.

The solution: Encourage status quo members to gradually retire from the scene of operations.

- ! Dilute their influence in management decisions. For example, give them an opportunity to convert their investment in the corporation to preferred stock.
- ! Engage estate planners who may suggest tax incentives for giving or selling some of their stock to younger relatives.
- ! Encourage them to take a larger role in community activities or in an industry association.
- ! Encourage their involvement in other directions, such as pursuit of personal hobbies and interests.
- ! Explore the possibility of restructuring the business, with a new partnership agreement, for example. (Proper legal advice is essential in restructuring.)

Such actions recognize the contributions of retreating members and assist them in recovering their equity. At the same time, the manager and active relatives can plan for the future.

HOW IS THE PIE DIVIDED?

Paying family members and dividing profits among them can be a challenge.

Many people feel they are underpaid, but the complaints may be more specific and more personal in the family-owned business. Uncle Jack just sits around and he makes more than I do. Aunt Sue goes to Europe on the returns of money her husband put into the business before he died ten years ago. Your brother goofed off and makes more than you do. How do you resolve these complaints? You can't entirely, but you can be as fair as possible.

- ! Equity that recognizes contributions can be distributed by restructuring the company.
- ! Salaries are best handled by matching them to industry guidelines. Determine local salary ranges for various jobs and use these as a guide for paying both family and nonfamily personnel. When you tie pay to a job description you recognize the value the industry puts on jobs and you treat all employees fairly.
- ! Fringe benefits can also be useful in establishing equity among family members. Deferred profit-sharing plans, pension plans, insurance programs and stock purchase programs offer excellent means to placate family members and, at the same time, help them build personal assets.

How the profit pie is divided is vital to growth in a small business. Profits are the seedbed for expansion, and lenders are influenced by what is done with them. Relatives should know the consequences to the business if all profits are converted into dividends.

WHERE DO YOU FIND MONEY?

Another major challenge in managing a family business is obtaining money for growth. Generally speaking, if the company is profitable, you can borrow from your local lender, but when growth is substantial, the company may outgrow its local bank. When you see prospects for expansion, you should begin to plan for it and consider techniques for financing. Planned financing may be a combination of

- ! Taking or refinancing a mortgage using the company's assets as collateral.
- ! Asking suppliers to extend credit on purchases.
- ! Factoring (selling) the company's receivables.
- ! Inventory financing.
- ! Borrowing from friends on a personal note basis.
- ! Borrowing the cash surrender value of life insurance policies owned by relatives.
- ! Obtaining a long-term loan from an insurance company.
- ! Working with a lender and the U.S. Small Business Administration (SBA) to get a business loan.
- ! Financing with a Small Business Investment Company licensed by SBA.

If the business is a small corporation, the following techniques also offer possible sources of money:

- ! Selling a portion of the stock for cash to the company's employees.
- ! Selling some of the stock for cash to another company. In a merger, you can use the credit of the larger company.
- ! Contacting a regional investment banker who may privately find a lender, using some of the company's stock as collateral.
- ! Contacting a national investment banker who will underwrite some of the company's stock. This is called going public.

Effective budgetary controls are important in seeking growth funds. Such controls help the managing relative determine the company's needs, and lenders regard them as evidence of good management.

INFORMATION EXCHANGE

In most communities, the manager of a family-owned business is not alone. Other individuals operate small companies for their families and provide a source of information, support and help.

Family business managers should seek out and cultivate relationships with their counterparts to exchange ideas with them and to learn how they've solved business problems with their own relatives.

In a small corporation, strategic thinking can be stimulated by including outsiders on the board of directors, people who are not relatives and who are from other types of businesses.

State and national trade associations also are good sources of information and help. Through them, the managing relative can get facts from noncompetitors.

CONCLUSION

There are no simple or quick solutions to the unique challenges faced by family businesses. But the first thing to do is recognize a problem or one that may develop. Here are some simple suggestions:

- ! Don't let the same lawyer handle all family members' affairs. Hire different attorneys to get new ideas and to ensure fairness in cases of disagreements among family members.
- ! Try to have all business agreements in writing:
 - buying and selling of shares, etc.
 - salaries and retirement age
 - dividend policies
 - limitations on sale of stock
 - lines of authority
 - liability of stockholders or partners
 - job descriptions
- ! When a parent transfers stock to a child, be certain there is a proxy arrangement. Establish a contingency plan for the stock in the event of the child's death.

- ! Conduct regular meetings with family members to talk about plans, programs, strategies and problems. Hold the meetings away from work yet in a business atmosphere.
 - ! Do not discuss business at family social gatherings or at home.
 - ! Use outside advisers who have no connection with or relationship to any family member.
 - ! Take advantage of family loyalty and affection. Use it to your benefit. Enjoy your business and work together for everyone's well-being and financial success.
 - ! Encourage family members to read this publication so they can understand some of the challenges arising in family business.
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APPENDIX: INFORMATION RESOURCES

U.S. Small Business Administration (SBA)

The SBA offers an extensive selection of information on most business management topics, from how to start a business to exporting your products.

SBA has offices throughout the country. Consult the U.S. Government section in your telephone directory for the office nearest you. SBA offers a number of programs and services, including training and educational programs, counseling services, financial programs and contract assistance. Ask about

- *SCORE: Counselors to America's Small Business*, a national organization sponsored by SBA of over 11,000 volunteer business executives who provide free counseling, workshops and seminars to prospective and existing small business people. Free online counseling and training at www.score.org.
- *Small Business Development Centers (SBDCs)*, sponsored by the SBA in partnership with state governments, the educational community and the private sector. They provide assistance, counseling and training to prospective and existing business people.
- *Women's Business Centers (WBCs)*, sponsored by the SBA in partnership with local non-government organizations across the nation. Centers are geared specifically to provide training for women in finance, management, marketing, procurement and the Internet.

For more information about SBA business development programs and services call the SBA Small Business Answer Desk at 1-800-U-ASK-SBA (827-5722) or visit our website, www.sba.gov.

Other U.S. Government Resources

Many publications on business management and other related topics are available from the Government Printing Office (GPO). GPO bookstores are located in 24 major cities and are listed in the Yellow Pages under the bookstore heading. Find a "Catalog of Government Publications" at <http://catalog.gpo.gov/F>

Many federal agencies offer Websites and publications of interest to small businesses. There is a nominal fee for some, but most are free. Below is a selected list of government agencies that provide publications and other services targeted to small businesses. To get their publications, contact the regional offices listed in the telephone directory or write to the addresses below:

Federal Citizen Information Center (FCIC)

<Http://www.pueblo.gsa.gov>

1-800-333-4636

The CIO offers a consumer information catalog of federal publications.

Consumer Product Safety Commission (CPSC)

Publications Request

Washington, DC 20207

http://www.cpsc.gov/cpsc/pub/pubs/pub_idx.html

The CPSC offers guidelines for product safety requirements.

U.S. Department of Agriculture (USDA)

12th Street and Independence Avenue, SW

Washington, DC 20250

<http://www.usda.gov>

The USDA offers publications on selling to the USDA. Publications and programs on entrepreneurship are also available through county extension offices nationwide.

U.S. Department of Commerce (DOC)

Office of Business Liaison

14th Street and Constitution Avenue, NW

Washington, DC 20230

<http://www.osec.doc.gov/obl/>

DOC's Business Liaison Center provides listings of business opportunities available in the federal government. This service also will refer businesses to different programs and services in the DOC and other federal agencies.

U.S. Department of Health and Human Services (HHS)

Substance Abuse and Mental Health Services Administration

1 Choke Cherry Road

Rockville, MD 20857

<http://www.workplace.samhsa.gov>

Helpline: 1-800-workplace. Provides information on Employee Assistance Programs Drug, Alcohol and other Substance Abuse.

U.S. Department of Labor (DOL)

Employment Standards Administration
200 Constitution Avenue, NW
Washington, DC 20210
The DOL offers publications on compliance with labor laws.

U.S. Department of Treasury

Internal Revenue Service (IRS)
1500 Pennsylvania Avenue NW
Washington DC 20230
<http://www.irs.gov/business/index.html>
The IRS offers information on tax requirements for small businesses.

U.S. Environmental Protection Agency (EPA)

Small Business Ombudsman
1200 Pennsylvania Avenue NW
Washington, DC 20480
<http://epa.gov/sbo>
Hotline: 1-800-368-5888
The EPA offers more than 100 publications designed to help small businesses understand how they can comply with EPA regulations.

U.S. Food and Drug Administration (FDA)

5600 Fishers Lane
Rockville MD 20857-0001
<http://www.fda.gov>
Hotline: 1-888-463-6332
The FDA offers information on packaging and labeling requirements for food and food-related products.

For More Information

A librarian can help you locate the specific information you need in reference books. Most libraries have a variety of directories, indexes and encyclopedias that cover many business topics. They also have other resources, such as

- **Trade association information**
Ask the librarian to show you a directory of trade associations. Associations provide a valuable network of resources to their members through publications and services such as newsletters, conferences and seminars.
- **Books**
Many guidebooks, textbooks and manuals on small business are published annually. To

find the names of books not in your local library check Books In Print, a directory of books currently available from publishers.

- **Magazine and newspaper articles**

Business and professional magazines provide information that is more current than that found in books and textbooks. There are a number of indexes to help you find specific articles in periodicals.

- **Internet Search Engines**

In addition to books and magazines, many libraries offer free workshops, free access to computers and the Internet, lend skill-building tapes and have catalogues and brochures describing continuing education opportunities.